

General Information Letter: Response to request to file composite returns on behalf of partnership, its Subchapter S corporation partners and their shareholders.

January 26, 1998

Dear:

This is in response to your letter dated January 19, 1997 in which you request a General Information Letter. Department of Revenue ("Department") regulations require that the Department issue only two types of letter rulings, Private Letter Rulings ("PLRs") and General Information Letters ("GILs"). PLRs are issued by the Department in response to specific taxpayer inquiries concerning the application of a tax statute or rule to a particular fact situation. A PLR is binding on the Department, but only as to the taxpayer who is the subject of the request for ruling and only to the extent the facts recited in the PLR are correct and complete. GILs do not constitute statements of agency policy that apply, interpret or prescribe the tax laws and are not binding on the Department. For your general information we have enclosed a copy of 2 Ill. Adm. Code Part 1200 regarding rulings and other information issued by the Department.

Although you have not specifically requested either type of ruling, the information you have provided requires that we respond with a general information letter.

In your request you stated:

On behalf of our client (C), we respectfully request a ruling concerning the ability to file a "composite" Illinois State Income Tax Return on Form IL-1023-C for the year ending December 31, 1997. In a telephone conversation with a representative of the Illinois Department of Revenue we were advised that such a filing was permitted under our client's circumstances. However, in order to ensure that we can rely on such advise, we request a written ruling as to whether our client may file a composite tax return under the following relevant facts:

Our client (C) is a Texas based limited liability partnership (LLP) comprised of approximately 10 partners. The partners of C are all Texas based S-Corporations. The S-Corporations each have only one individual shareholder who are not Illinois residents.

C is in the business of providing professional and other consultation services. C recently employed a resident of Illinois who will be working from their home office on customers/clients located in other states. Employing an Illinois resident who is performing work at an Illinois work location will apparently require C to file an Illinois Tax Return. All of the partners of C and the shareholders of its S-Corporation partners are non-residents of Illinois and have no other Illinois source income. The S-Corporations have no other income other than the pass-through income from C,

and filing a composite tax return for C would produce no loss of revenue to the State of Illinois.

Based on the above please provide a written ruling as to C's eligibility to file a composite tax return.

Department Analysis

You are correct to assume that the hiring of an Illinois resident to perform work in Illinois creates nexus between your client, C, and Illinois. Section 304 of the Illinois Income Tax Act ("IITA") provides:

§. 304. Business Income Of Persons Other Than Residents.

(a) In general. The business income of a person other than a resident shall be allocated to this State if such person's business income is derived solely from this State. If a person other than a resident derives business income from this State and one or more other states, then, except as otherwise provided by this Section, such person's business income shall be apportioned to this State by multiplying the income by a fraction, the numerator of which is the sum of the property factor (if any), the payroll factor (if any) and 200% of the sales factor (if any), and the denominator of which is 4 reduced by the number of factors other than the sales factor which have a denominator of zero and by an additional 2 if the sales factor has a denominator of zero.

(2) Payroll Factor.

(A) The payroll factor is a fraction, the numerator of which is the total amount paid in this State during the taxable year by the person for compensation, and the denominator of which is the total compensation paid everywhere during the taxable year.

(B) Compensation is paid in this State if:

(i) The individual's service is performed entirely within this State;

(ii) The individual's service is performed both within and without this State, but the service performed without this State is incidental to the individual's service performed within this State; or

(iii) Some of the service is performed within this State and either the base of operations, or if there is no base of operations, the place from which the service is directed or controlled is within this State, or the base of operations or the place from which the service is directed or controlled is not in any state in which some part of the service is performed, but the individual's residence is in this State. Beginning with taxable years ending on or after December 31, 1992, for residents of states that impose a comparable tax liability on residents of this State, for purposes of item (i) of this paragraph (B), in the case of persons who perform personal services under personal service contracts for sports performances, services by that person at a sporting event taking place in Illinois shall be deemed to be a performance entirely within this State.

Section 305 of the IITA goes on to explain how partners in such a company must allocate income to Illinois.

§. 305. Allocation Of Partnership Income By Partnerships And Partners Other Than Residents.

(a) Allocation of partnership business income by partners other than residents. The respective shares of partners other than residents in so much of the business income of the partnership as is allocated or apportioned to this State in the possession of the partnership shall be taken into account by such partners pro rata in accordance with their respective distributive shares of such partnership income for the partnership's taxable year and allocated to this State.

(b) Allocation of partnership nonbusiness income by partners other than residents. The respective shares of partners other than residents in the items of partnership income and deduction not taken into account in computing the business income of a partnership shall be taken into account by such partners pro rata in accordance with their respective distributive shares of such partnership income for the partnership's taxable year, and allocated as if such items had been paid, incurred or accrued directly to such partners in their separate capacities.

(c) Allocation or apportionment of base income by partnership. Base income of a partnership shall be allocated or apportioned to this State pursuant to Article 3, in the same manner as it is allocated or apportioned for any other nonresident.

(d) Cross reference. For allocation of partnership income or deductions by residents, see Section 301 (a). (Source: P.A. 84-550.)

Finally, §502 explains the filing requirements:

(a) In general. A return with respect to the taxes imposed by this Act shall be made by every person for any taxable Year:

(d) Partnerships. Every partnership having any base income allocable to this State in accordance with section 305(c) shall retain information concerning all items of income, gain, loss and deduction; the names and addresses of all of the partners, or names and addresses of members of a limited liability company, or other persons who would be entitled to share in the base income of the partnership if distributed; the amount of the distributive share of each; and such other pertinent information as the Department may by forms or regulations prescribe. The partnership shall make that information available to the Department when requested by the Department.

Accordingly, each partnership must file a separate Illinois income tax return. Composite reporting, your true question, is enabled by §502(f), which states:

(f) The Department may promulgate regulations to permit nonresident individual partners of the same partnership, nonresident Subchapter S corporation shareholders of the same Subchapter S corporation, and nonresident individuals transacting an insurance business in Illinois under a Lloyds plan of operation, **and nonresident individual members of the same limited liability company that is treated as a partnership under Section 1501 (a)(16) of this Act**, to file composite individual income tax returns reflecting the composite income of such individuals allocable to Illinois and to make composite individual income tax payments. The Department may by regulation also permit such composite returns to include the income tax owed by Illinois residents attributable to their income from partnerships, Subchapter S corporations, insurance businesses organized under a Lloyds plan of operation, or limited liability companies that are treated as partnership under Section 1501 (a)(16) of this Act, in which case such Illinois residents will be permitted to claim credits on their individual returns for their shares of the composite tax payments. This subsection (f) applies to taxable years ending on or after December 31, 1987. (emphasis added)

Pursuant to §502(f), nonresident S corporation partners of a limited liability partnership may not use composite reporting for income allocable to Illinois. While the statute allows composite reporting in some situations for limited liability partnerships, it only allows composite reporting for non-resident individual partners. Accordingly, as the IITA provides no statutory authority for composite reporting by non-resident S corporation partners of a limited liability partnership, your client may not file a composite return in Illinois.

If you have additional questions please feel free to contact me at the above address.

Sincerely,

Charles E. Matoesian
Staff Attorney
Income Tax Division